

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company d/b/a)	
Ameren CILCO)	
)	06-0070
Central Illinois Public Service Company)	06-0071
d/b/a Ameren CIPS)	06-0072
)	(Consolidated)
Illinois Power Company d/b/a Ameren IP)	
)	
Proposed general increase in rates for)	
delivery service.)	

**INITIAL BRIEF ON REHEARING OF
THE PEOPLE OF THE STATE OF ILLINOIS**

The People of the State of Illinois

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NOW COME the People of the State of Illinois (“the People”), by LISA MADIGAN, Attorney General of the State of Illinois, and pursuant to the Illinois Administrative Code Part 200.800, 83 Ill. Admin. Code 200.800, submit this Initial Brief on Rehearing in AmerenCILCO’s, AmerenCIPS’ and AmerenIP’s (“the Ameren Companies,” “the Companies” or “Ameren”) proposed general increase in rates for delivery service in the above-referenced dockets.

I. Summary of Arguments

In the Illinois Commerce Commission’s (“Commission”) Final Order issued on November 21, 2006, the Commission, unable to determine the reasonableness of Ameren’s Administrative and General (“A&G”) expenses, directed the Ameren Companies to conduct a study to show the costs of services obtained from Ameren Services and compare those costs with market costs. See Final Order, Docket 06-0070 (Cons.) at p. 67. The Ameren Companies responded with the testimony of Michael J. Adams, which compared the A&G costs of the Ameren Companies with the A&G costs of purportedly comparable companies selected by Mr. Adams. See Ameren Ex. 54.0 (Revised) at p. 17; see also Ameren Ex. 54.9 (Revised) and Ameren Ex. 54.10 (Revised).

Ameren’s presentation of A&G costs (excluding Pensions and Benefits (“P&B”) costs) as a percentage of total Operations and Maintenance (“O&M”) expense is irrelevant because Mr. Adams’ admitted failure to remove purchased power costs from total O&M, “undermine[s] the credibility of the analysis results.” Staff Ex. 26.0 (Corrected) at p. 7:180-181.

Ameren’s presentation of A&G expense per customer is also a false comparison because Mr. Adams’ inclusion of vertically integrated companies (those companies with

production facilities and operations) and “wires only” utilities companies (that is, companies with transmission and distribution operations, but no, or insignificant, production operations) misrepresents Ameren’s relative performance of A&G costs per customer when compared to other wires only companies.

The Commission, therefore, should affirm the ruling in its Final Order disallowing \$50.3 million in A&G expense due to lack of substantiation. See Final Order, Docket No. 06-0070 (Cons.) at p. 66.

II. Ameren Twice has Failed to Provide the Commission with Evidence Sufficient to Determine Whether Allowing Recovery of Administrative and General Expenses would Result in Rates that are Just and Reasonable.

The Illinois Public Utilities Act places the burden of proving that proposed rates are just and reasonable squarely upon the utility. 220 ILCS 5/9-201(c). In Phase I of this case, the Commission disallowed \$50.3 million in A&G expenses due to lack of substantiation. See Final Order, Docket No. 06-0070 (Cons.), at p. 66-67. In the rehearing, Ameren has again failed to substantiate the reasonableness of its A&G expense and the Commission should therefore affirm the disallowance it ordered in its Final Order.

A. The Companies have again failed to meet their burden of proof to establish the justness and reasonableness of its proposed rates, and the Commission should therefore affirm the ruling in its Final Order.

The Public Utilities Act states, “the burden of proof to establish the justness and reasonableness of the proposed rates...shall be upon the utility.” 220 ILCS 5/9-201(c). In the Final Order, the Commission stated that it “has the obligation to ensure “just and reasonable” rates but cannot do so if it is unable to determine if the services that the

Ameren companies receive through Ameren Services are indeed being provided at the lowest cost.” See Final Order, *supra*.

Due to the irrelevant comparisons provided by Ameren to justify its A&G expenses on rehearing, the Commission once again finds itself without relevant evidence with which to determine whether allowing Ameren recovery of its proposed A&G expenses would result in just and reasonable rates. Therefore, Ameren has failed to meet its burden of proof on rehearing and the Commission should affirm its decision in the Final Order to disallow \$50.3 million in A&G costs.

In Phase I of Docket No. 06-0070 (consolidated), Ameren requested increases in Administrative and General (“A&G”) expense for each of its Illinois utilities. The proposed increases in A&G expense ranged from a 63.8% increase for CIPS, to a 394.3% increase for CILCO. Across the three utilities, the proposed increase equaled 210%. See Final Order, Docket 06-0070 (consolidated) at p. 66. The Commission disallowed \$50.3 million of Ameren’s proposed A&G expense due to lack of substantiation. See *id.* In making its determination, the Commission stated:

The Commission is concerned about the magnitude of the increase in A&G expenses and the lack of substantiation for these increases. It seems that the increase may be attributable to the Ameren companies’ relationship with Ameren Services. However, the record does not contain enough information for the Commission to assess whether the Ameren companies’ are being allocated a fair share of the costs of these services for ratemaking purposes or whether amounts paid to Ameren Services are reasonable for such services. The Commission has the obligation to ensure “just and reasonable” rates but cannot do so if it is unable to determine if the services that the Ameren companies receive through Ameren Services are indeed being provided at the lowest cost. Therefore, the Commission directs the Ameren companies to conduct a study to show the costs of services obtained from Ameren Services and compare those costs with market costs.

Id., at pp. 66-67.

Ameren responded to this directive by submitting testimony to support the reasonableness of its A&G expense in the rehearing. Ameren witness Adams presented what purported to be a comparison of the A&G expense incurred by the Ameren Illinois companies to the A&G expense incurred by comparable utilities. Ameren Ex. 54.0 (Revised), pp. 17-20.

Mr. Adams employed two benchmarks in his comparative analysis: 1) A&G (excluding Pensions and Benefits (“P&B”) expense) as a percentage of total Operations & Maintenance (“O&M”) expense (excluding P&B), and 2) A&G (excluding P&B expense) per customer. See Ameren Ex. 54.9 (Revised) and 54.10 (Revised), respectively.

Describing his results, Mr. Adams stated:

when comparing the Ameren Illinois Utilities’ test year A&G expenses without pensions and benefits costs to total O&M excluding fuel expenses for the peer group Ameren IP was in the 1st quartile of the peer group while Ameren CIPS and Ameren CILCO were both in the 2nd quartile.

When comparing the Ameren Illinois Utilities’ test year A&G expense without pensions and benefits expenses per customer to the peer group companies, Ameren IP was in the 1st quartile of the peer group, Ameren CIPS was in the 2nd quartile and Ameren CILCO was in the 3rd quartile.

Ameren Ex. 54.0 (Revised) at pp. 19-20:430-438.

Consistent with Mr. Adams own admission, purchased power costs should have been removed from total O&M costs for Ameren to have presented a meaningful comparison of A&G as a percentage of total O&M costs. Likewise, a relevant comparison of A&G costs per customer would have compared the three Ameren companies only with other wires companies. The comparisons submitted by Ameren

were meaningless and of no probative value in measuring the reasonableness of the Ameren A&G expense in comparison to other companies.

In Ameren's presentation of A&G as a percentage of total O&M, Mr. Adams admits that he fails to remove an item from total O&M which would significantly impact the analysis. See AG Cross Ex. 1 (on Rehearing); see also Ameren Ex. 56.0, pp.25-26. In Ameren's presentation of A&G costs per customer, Mr. Adams compares "wires" companies to vertically integrated companies, thereby misrepresenting Ameren's performance regarding A&G costs per customer and frustrating the Commission's ability to determine the reasonableness of Ameren's A&G expense.

For the following reasons, the Commission should affirm the ruling in its Final Order and disallow \$50.3 million in A&G expenses due to lack of substantiation.

- B. Mr. Adams' Presentation of A&G (excluding P&B) expense as a percentage of total O&M expense excluding (excluding P&B) is of no probative value in measuring the reasonableness of Ameren's A&G expense when compared to other companies.

In calculating A&G as a percentage of total O&M, Mr. Adams removed fuel expense from the total O&M, the denominator in the calculations.¹ To put the comparison on an equal basis for all the companies in the study, Mr. Adams should have also removed purchased power from the total O&M.² Indeed, Mr. Adams himself acknowledged that such a correction was necessary, but then repeatedly failed to make that correction. See id.

¹ Removing components such as fuel costs from the denominator naturally reduces that number. Reducing the denominator in the equation necessarily increases the value of the quotient, and therefore A&G as a percentage of total O&M would increase for companies with fuel expense.

² Fuel expense is one of the main expenses in producing power for vertically integrated utilities. Purchased power expense is the equivalent of fuels expense for wires only companies who do not use fuel.

Mr. Adams' failure to correct his analysis in a way he acknowledged as appropriate renders his comparison of A&G as a percentage of total O&M meaningless. In response to discovery requests, Mr. Adams stated, "Both fuel and purchased power should have been excluded from the analysis." See AG Cross Ex. 1 (on Rehearing) and Tr. at pp. 219-220:1-3. In his rebuttal testimony, Mr. Adams again acknowledged that removing both fuel and purchased power costs from total O&M would make the companies in his peer group "comparable" and place the companies "on an equal footing." Ameren Ex. 56.0, p. 25:509-514; Tr. at 220:11 – 221:8.

It is important to note that both in the response to discovery and in his rebuttal testimony, Mr. Adams definitively and categorically stated that it was necessary to remove purchased power expense in order to make a valid comparison, or to place the companies "on an equal footing," as he put it. Ameren Ex. 56.0, supra; see also, Tr. at p. 221:5-8. Indeed, Mr. Adams even referred to his benchmarking analysis as if it had excluded purchased power stating:

The benchmarking analysis, however, compares the A&G expenses to total O&M expenses, which would include any non-fuel and non-purchased power expenses incurred associated with owning, operating and maintaining the generation facilities.

Id., p 26, lines 523-526.

Yet, while Mr. Adams submitted revised exhibits subsequent to his response to AG 1-4.0 and to his rebuttal testimony, he chose not to make the correction that he had said, on multiple occasions, was necessary. When asked why he failed to make the necessary corrections, Mr. Adams cited the possible existence of other "volatile" expenses that should be excluded. AG Cross Ex. 2.0 (on Rehearing). However on cross-

examination, Mr. Adams acknowledged the absence of any analysis of the volatility of those expenses or the extent to which their inclusion affected his comparison.

Q: But you didn't present any analysis of the volatility of these expenses or the extent to which their inclusion has affected your comparison, have you?

A: I have not.

Tr. at pp. 224:20 – 225:2.

Mr. Adams' failure to remove these other so-called volatile expenses (if indeed they should have been removed) in no way validates the failure to remove purchased power expense. If Mr. Adams actually believed that the inclusion of the "volatile" expenses improperly affected his comparison, then the proper remedy would be to remove those expenses, not to willfully neglect to remove a major expense that he admitted should have been removed. The excuses offered by Mr. Adams for his failure to remove purchased power from total O&M in his comparison simply lack credibility.

In fact, the removal of purchased power expense would substantially alter the results of the A&G as a percentage of O&M. As can be seen in AG Cross Exhibit 3, purchased power is by far the largest component of O&M for each of the Ameren companies. See AG Cross Ex. 3, Column AA. Removing the purchased power from the total O&M for the Ameren companies would more than double the A&G as a percentage of O&M for each of those companies and would affect their ranking in relation to the other companies in the peer group. Mr. Adams' removal of fuel expense from total O&M while failing to remove purchased power expense invalidates his comparison based on A&G as a percentage of total O&M. Indeed, Mr. Adams admitted as much.

Ameren's comparison of A&G costs as a percentage of total O&M again fails to substantiate the reasonableness of its A&G expenses, and the Commission should affirm the ruling in its Final Order to disallow \$50.3 million in A&G costs.

- C. The peer group selected by Ameren to compare A&G costs per customer inappropriately compares vertically integrated companies to wires only companies, thereby undermining the Commission's ability to meaningfully determine the reasonableness of Ameren A&G costs.

While the inclusion of purchased power in total O&M does not affect the comparison of A&G per customer, the problem with Ameren's comparison of A&G costs per customer stems from the choice of companies included in Mr. Adams' peer group. See Ameren Ex. 54.10 (revised). The peer group selected by Mr. Adams includes both integrated utilities (that is, companies with production facilities and operations) and "wires only" utilities companies (that is, companies with transmission and distribution operations, but no, or insignificant, production operations), thereby diminishing the relevance of the comparison.

Staff Witness Lazare identified the fallacy of comparing wires only companies to companies with a significant production function. Mr. Lazare explained in his direct testimony on rehearing why it is inappropriate to compare the A&G expense of wires companies to the A&G of integrated utilities. Mr. Lazare stated

the problem lies with the peer group chosen for the analysis. The inclusion of a number of utilities that continue to have a production function undermines the meaning of the results.

Staff Ex. 26.0 (Corrected) at p. 6:143-145. Mr. Lazare continued, "[t]he problems with the peer group used for the analysis undermine the credibility of the analysis results." Id., at p. 7:180-181. Accordingly, Mr. Adams' analysis in his Exhibit 54.10 is effectively meaningless.

Mr. Adams' responses to discovery did not explain his decision to compare vertically integrated utilities to wires only utilities. Mr. Adams was asked in discovery to explain why he "believes that it is appropriate to compare the administrative and general expense of "wires only" electric utilities to fully integrated electric utilities." See AG Cross Ex. 4. In his response, he stated only that he made no such distinction, but did not explain why he believes such a comparison is appropriate. Id.; see also, Tr. at p. 232:16-19.

In his rebuttal testimony, Mr. Adams stated that other than pensions and benefits he would "expect" that there would not be much incremental A&G associated with regulated generation, and that he did not "believe" that there would a material impact in the benchmarking analysis associated with any A&G related to the production function. Ameren Ex. 56.0, p. 27:542-544. On cross examination, Mr. Adams admitted that he did not have any study or analysis to support his "expectation" or "belief" regarding the effect of generation ownership on A&G per customer.

Q: Other than your expectation and your belief, you have not provided any analysis of the effect of the ownership of production facilities and operations on the amount of A&G expense incurred, have you?

A: I have not.

Tr. at p. 236:2-7.

In fact, the available evidence demonstrates that the A&G per customer is substantially affected by the existence of production operations. Mr. Adams agreed that the three Ameren Illinois companies are wires companies. Tr. at p. 240:2-4.³ There were

³ AmerenCILCO incurred some minor production expenses in 2004, the year used by Mr. Adams in his study; but those production expenses were not of a magnitude that would disqualify AmerenCILCO as a wires company, as Mr. Adams agreed.

12 other utilities in Mr. Adams group with production expenses less than AmerenCILCO, both in absolute terms or as a percentage of total operation maintenance expense. See AG Cross Ex. 6, Column AD; see also, Tr. at p. 239:17-240:1. These 13 companies, including the Ameren companies, can fairly be described as wires companies.⁴

By contrast, of the 38 other companies in Mr. Adams' peer group each had power production expenses (including fuel, but excluding purchased power) at least 6.9 times as great as the power production expenses incurred by AmerenCILCO. See AG Cross Ex. 6.0 (on Rehearing), Column AC, Row 31. The power production expenses incurred by these 38 other companies far exceeded the power production expenses incurred by the wires companies both in absolute terms and as a percentage of total O&M. See *id.* These other 38 companies can fairly be described as integrated utilities.

Had Mr. Adams investigated how the existence of production operations affected A&G per customer, he would have discovered that the Ameren Companies were in fact not performing as well as the peer group companies in terms of A&G per customer. Specifically, Mr. Adams would have discovered first, that every one of the wires companies in his peer group falls into the first quartile in his study, except for three: CIPS, CILCO, and United Illuminating. Ameren Ex. 54.10 (revised); see also, AG Cross Ex. 7.0 (on Rehearing) and Tr. at p. 240:5-18. Second, United Illuminating is the only wires company in the fourth quartile. Ameren Ex. 54.10 (revised); see also AG Cross Ex. 7.0 (on Rehearing) and Tr. at pp. 240:19 – 241:5. Third, aside from CIPS and CILCO, there are no wires companies in the second or third quartiles. Ameren Ex. 54.10

⁴ At trial, Mr. Adams accepted, subject to check, that 13 companies of the 51 companies in his peer group had O&M costs, excluding purchased power and fuel costs, of greater than \$16 million. These 13 companies can be fairly described as wires only companies because their production costs are nonexistent or immaterial as seen in Mr. Adams' work papers, AG Cross Ex. 6, Column AD.

(revised); see also AG Cross Ex. 7.0 (on Rehearing) and Tr. at p. 241:15-22. Fourth, the A&G per customer for the wires companies, excluding the three Ameren companies, is approximately \$75. Tr. at p. 242:1-8. Finally, the A&G per customer for the companies with production operations is approximately \$143. Tr. at p. 242:9-13.

Clearly, the integrated utilities incur higher A&G per customer, exactly for the reasons cited by Mr. Lazare. Mr. Adams' contention that he does not believe "A&G expenses incurred associated with owning regulated generation" would result in a "material impact on the benchmarking analysis," is unfounded. Ameren Ex. 56.0 at p. 27:542-544. As the evidence clearly demonstrates, it is improper to compare the A&G per customer of a wires utility to A&G per customer of an integrated utility.

The results of comparing the Ameren Illinois companies to the other wires companies in Mr. Adams' peer group are shown on AG Cross Exhibit 7. IP is about in the middle with regard to A&G per customer. See Tr. at p. 243:3-6. CIPS and CILCO have the second and third highest A&G per customer, respectively, of the wires companies. See Tr. at p. 243:7-10. Thus, on balance the Ameren Illinois companies, are not "above average" in A&G expense per customer, as claimed by Mr. Adams; rather, one of the companies is about average, and the other two are well below average. See AG Cross Ex. 7 (on Rehearing).

Accordingly, the Commission's disallowance of a portion of the A&G expense in the Final Order as being excessive is entirely reasonable based on the A&G expense incurred by the Ameren Illinois companies relative to the A&G expense incurred by comparable companies, and the Commission should affirm the disallowance it ordered in its Final Order.

III. Conclusion

WHEREFORE, for the reasons contained herein, the Commission should affirm its ruling in the Final Order to disallow \$50.3 million in A&G costs due to lack of substantiation of these increases.

Respectfully Submitted,

The People of the State of Illinois

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